

What Sets
High-Performance
Companies Apart in the
Changing Consumer
Goods Landscape

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These are testing times for consumer packaged goods companies.

More than ever, companies are facing an unprecedented difficult set of challenges on all fronts retail, consumer, competitive and growth. Profit margins are low, revenue growth is even lower, and costs are rising. Managers have responded by relying on their gut instincts and going with tried-and-true measures. But the rules of the game are changing and conventional responses are failing to produce

expected results. The situation at some companies has become so dire that many are literally scrambling for survival.

Specifically, a 2003 GMA Logistics Study highlights the fact that consumer goods organizations are faced with demands for increased service levels (completeness and speed) to retailers, while at the same time facing cost increases from holding additional inventory,



higher logistics costs, increased manufacturing costs, and increased trade promotion and collections costs.

At Accenture, our client experiences combined with research have led us to identify some winning traits among leading consumer goods companies that are supporting these companies as high-performing businesses that are looking

for new opportunities, creating innovative products and services, maximizing technology and leading the marketplace.

Whether an organization is trying to do more with less or whether it is preparing for the next period of growth and innovation, there are several ways a company can strive to develop certain key competencies that high-performing

businesses demonstrate consistently over time. Getting there first requires taking a hard look at the industry and determining where strategically to improve one's business.

Understanding How the Industry Is Changing

Every industry has undergone change in recent years, but consumer packaged goods in particular is experiencing fundamental change. To get a better sense of tomorrow's world, Accenture examined the myriad market forces affecting the consumer goods industry and summarized them into several trends: challenges from retailers, challenges from consumers and new forms of competition that are all contributing to greater commoditization. These forces are placing tremendous pressure on consumer goods companies' ability to grow top-line revenue and deliver strong shareholder returns, and could transform the industry more profoundly than anything of the past.

Challenges from Retailers

Retailers continue to gain power over consumer goods manufacturers as the retail industry grows and consolidates. This is evidenced by the fact that in 2002 the top five grocery retailers accounted for approximately 25 percent of the US grocery and consumables market. This leaves manufacturers with having to address a radically changing relationship with retailers.

Retailers have slowly but surely been winning the favor of consumers and gaining competitive ground by introducing private-label brands, which have become the fastest growing segment in the industry and a direct threat to manufacturers' brands. Today, private label holds the number 1 share position in 25

percent of all categories that offer a store brand

In 2002, sales for the top 150 publicly and privately held retailers increased 6.5 percent, and more importantly, operating profits grew by 15 percent. Sheer size is playing into the hands of retailers, increasingly giving them the upper hand at demanding price concessions from manufacturers. All too often, if manufacturers do not comply with the terms they are dealt, they lose. Retailers, meanwhile, continue to build advantages with new solution offerings.

Retailers also are reaping other benefits from manufacturers. Service levels to retailers have increased as evidenced by shorter order cycle times (a 58% decrease) and better

perfect order rates (a 9.3% increase) over the last four years, according to the 2003 GMA Logistics Study. Retailers also have benefited by holding less inventory. Unfortunately, manufacturers have provided these benefits to retailers at a cost to themselves, not as a result of improved efficiencies. This is reflected in the higher logistics (a 12% increase) and manufacturing costs (a 6% increase) manufacturers are bearing as well as higher inventory levels over the same four-year period. Most important, these costs increases have not been recovered by charging higher prices.

Challenges from Consumers

Noticeable changes are occurring on the consumer front as well. Brand loyalty is diminishing as consumers have become more value driven and diverse in their purchasing decisions. Retailers and manufacturers are resorting to price cuts to help stimulate demand, resulting in downward pressure on margins. Consumers also are becoming more segmented (e.g., economic disparity, ethnic diversity, age stratification that is fragmenting demand and increasing product complexity).

Consumer goods companies also are challenged by meeting more demanding desires of consumers for products that are quick, easy and healthy. Consumers also are looking for products that directly relate to their quality of life: improving their physical health and sense of well-being and helping them learn or providing intellectual stimulation. These desires introduce an entirely new set of buying criteria that consumer goods companies have to now consider.

Naturally, a big factor for consumer goods companies in seeking new growth options is to consider changing demographics, particularly the aging US population. Aging baby boomers are narrowing their buying to a more specialized assortment of goods, such as health and beauty aids, and nutraceutical products. Of these, health and beauty aids represent the largest growth segment for older Americans. The buying shift of this demographic group is blurring the distinction between consumer goods and pharmaceutical companies.

In addition, the Hispanic population is estimated to double by 2030, with one of out of every five Americans predicted to be of Hispanic origin. Greater diversity complicates the efforts of manufacturers to gain loyal, long-term satisfied customers. The bright spot, however, is the growth opportunity for those companies that can successfully market to the largest, highest-growth ethnic groups.

Potential growth opportunities also exist in many emerging markets where large populations and population growth rates lend themselves to consumer goods product growth. The key product attributes for these markets would include low-cost product with small package sizes that provide low price points and product formulations that are cost effective.

The typical response to changes in the marketplace for consumer goods companies has been to come up with line extensions every which way. But more and more, what we are seeing is that consumers really are not getting products that make their lives significantly better. Ironically, manufacturers are creating more confusion in the marketplace and complicating their supply chains rather than creating growth. Those companies that are high performers are developing truly innovative product lines, designing new, customer-centric offerings or creating markets that previously did not exist.

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Challenges from New Forms of Competition

If the changes in consumer and retailer relationships were not enough to keep manufacturers on their toes, new forms of competition are also cause for concern. One potentially exploding area is that of "functional foods" that pharmaceutical companies and some stand-alone food companies have begun to launch. These are foods that serve a purpose beyond basic nourishment, often meeting specific health and medical needs. One example is Benecol, a margarine that contains cholesterol-lowering agents. This trend leaves manufacturers competing with not just retailers, but with pharmaceutical and other nonfood companies.

Another area of competition is the continuing growth in out-of-home dining and growth in the number of purveyors of prepared meals. In response to the time-starved life styles of consumers, purchases of prepared meals, which include restaurant meals and take-home prepared meal solutions, are growing steadily. Today, more than half of food consumed by Americans is eaten outside the home. The restaurant industry's anticipated sales of \$440.1 billion equal 4 percent of the US gross domestic product. Consumers' hectic life styles are causing retailers, fast-food outlets and traditional restaurants to fight for "share of stomach," as well as share of discretionary dollars.

The United States is more and more a wired population, making the online world yet another form of competition for consumer goods companies. As the percentage of consumers with Internet access increases, e-commerce has become a viable alternative to fighting traffic and spending time in stores.

Moreover, the Internet's effect on price transparency in many markets contributes to the growing commoditization of some products and services.

Still other forms of competition come from the effects of trade price stagnation and deflation. Deflation is a threat in the consumer products industry, because through trade and consumer promotions, the consumer has been trained to wait for a lower price. Similarly, the volatility of raw materials and ingredients can significantly impact profitability, and manufacturers often find it very difficult to pass price increases on to the end consumer. A relatively recent example is the vanilla crop that has failed in Madagascar. With the boom in vanilla-based soft drinks, such as Vanilla Coke, the price of this ingredient has more than doubled with manufacturers taking the hit.

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These Market Forces Are Driving Greater Commoditization

Consumer goods companies have been aware of these market forces for years, which have had the cumulative effect of turning more and more products into commodities. The biggest force has no doubt been the Wal-Mart effect and its increasing dominance of the retail landscape. As the world's largest company, Wal-Mart has squeezed billions of dollars in cost efficiencies out of the retail supply chain and wields its clout with almost every major US consumer goods company. It controls a rising proportion of manufacturer sales and national imports, including \$12 billion from China. Through its dominance, it has set the bar for supply chain excellence.

Through aggressive everyday low prices and private-label strategies, Wal-Mart has changed the landscape of consumer expectations for value. Average grocery prices, for example,

are 14 percent lower in those markets that Wal-Mart enters. The net effect of Wal-Mart's buying power over consumer goods manufacturers is that the retailer is reducing an ever-greater number of products to mere commodity status, leaving little room for profits.

Even consumers have noticed the preponderance of commoditization. A survey by Accenture of 3,500 consumers in five countries found that many consumers are not buying because they are disappointed by the level of innovation they perceive in virtually all product and service sectors. Overall, nearly one-third of all consumers polled feel that most products and services created today have nothing new about them. Moreover, 74 percent of consumers say all stores look alike within their category.

With no change in sight, consumer goods companies need to do something different to position

themselves effectively to combat these trends and stay in the game. The consequence of not changing is becoming caught in the cycle of commoditization declining prices, excess inventory and slower growth.

Going Beyond Conventional Approaches: What High-Performance Companies Do

Despite seemingly insurmountable challenges, high-performance consumer goods companies have been able to overcome obstacles, even in a sluggish economy. These companies have demonstrated the ability to consistently deliver respectable returns to shareholders, grow revenue, create value over the cost of capital and manage for today as well as tomorrow.

Accenture examined the underlying drivers of sustainable performance of these companies. We uncovered several competencies that distinguish those companies from the rest of the consumer goods industry. Although there is no one formula for success, higher performers are consistently well above average in the mastery of six key competencies: clear strategic intent, obsessive customer focus, innovation and execution to value, talent management, alliance and collaboration capability, and operational excellence.

For purposes of this paper, we have chosen to focus on operational excellence with efficient supply chains since it is such a critical area for consumer goods companies to achieve growth and improve performance in today's fiercely competitive marketplace. (More

information about the other five competencies is available by contacting Accenture.)

High-performance companies generally made the decision to make supply chain management strategic rather than operational, and subsequently made the effort to translate that decision into the company's business architecture and operating model. Across all industries, Accenture found that high-performance companies that have mastered supply chain management realize a premium of anywhere from 7 percent to 26 percent over their peers in market capitalization, depending on their industry. The good news for any consumer goods manufacturer is that high-performance companies are not necessarily born, but can be made.

Achieving Baseline Operational Excellence Through Resource and Capability Optimization

Across the spectrum of high-performing consumer goods companies, all without fail, execute their businesses like well-oiled machines. The consumer goods companies that execute well rigorously focus on the development and leverage of scale of their mix of assets, business processes and capabilities of their people in key areas, such as sourcing, manufacturing, distribution, fulfillment and trade promotion.

Tremendous opportunities exist today for consumer goods manufacturers to take their performance in these functions to the next level by effectively leveraging technology. Embracing emerging consumer packaged goods and retail technology is the catalyst that enables companies to achieve previously unattainable operational goals. The current CPFR, UCCnet and RFID initiatives being driven by Wal-Mart and other major retailers are aimed largely at achieving breakthrough supply chain results.

Effectively deploying and capturing the value inherent in these initiatives requires an organization to have an efficient scalable infrastructure, including an integrated enterprise application suite as a foundation.

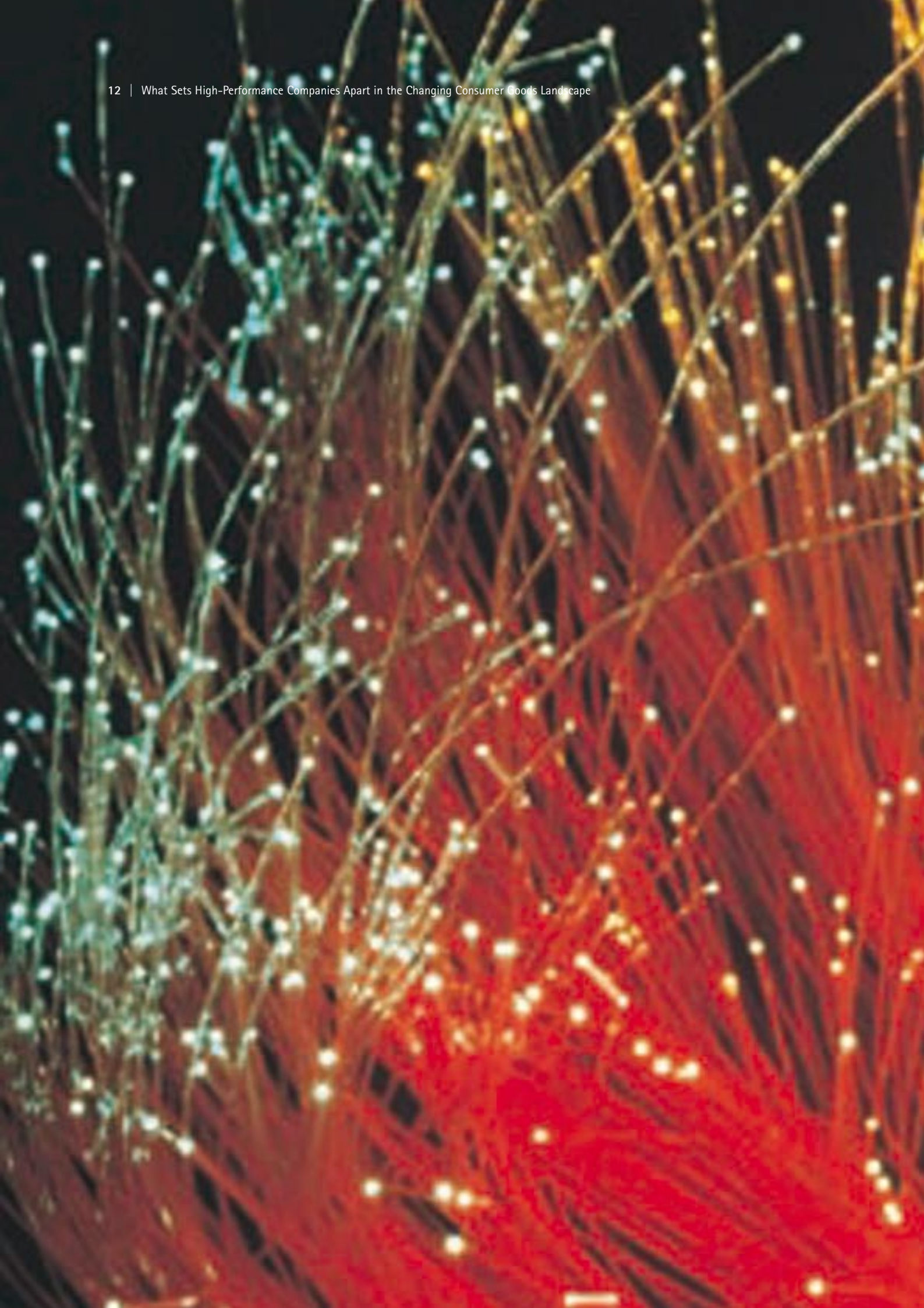
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Most large consumer packaged goods companies have implemented this in the form of ERP. Some have been successful. Others have struggled, largely because of the large number of gaps and customizations required to enable a dynamic consumer packaged goods process model.

Areas such as trade promotion management, complex pricing and contracts, unique product variants and measures, and high SKU volatility traditionally have not been offered by the large ERP providers. These gaps have created the perception amongst many mid-market CPG manufacturers that integrated enterprise applications are a luxury affordable by only the largest retailers.

What has resulted is that a surprisingly large number of CPG manufacturers still fall short of being able to plan for demand and build an integrated production plan, distribution plan and fulfillment plan against those projections. Moreover, adjusting plans during the business cycle to account for actual orders and inventory conditions remains elusive to many, resulting in suboptimal cost structures and unsatisfied customers.

In what may be a breakthrough for the consumer goods industry, Accenture and PeopleSoft (includes the former J.D. Edwards) have recently launched an integrated, end-to-end solution to meet this industry need that may provide the solution many companies need. The solution is modularized and can be implemented as a whole or in parts.



Optimizing the Supply Chain with an Enhanced End-to-End Solution

Supply chain management is where a consumer goods company must excel to achieve baseline operational excellence. Until recently, virtually no software package connected all of a manufacturer's supply chain components, leaving companies to rely on independent and costly systems. Accenture and PeopleSoft have filled this void by creating the premier consumer goods enterprise solution, PeopleSoft EnterpriseOne Supply Chain Management (SCM) 8.9 and Financial Management (FM) 8.9.

Together, Accenture and PeopleSoft kicked off a more than 10,000-person-day effort to build and deliver a comprehensive enterprise management solution for the consumer packaged goods industry. Working in collaboration side by side to turn our joint vision into reality, our two organizations brought our best skills to the table. Accenture focused on functionality enhancement direction while PeopleSoft led the product development. Accenture contributed extensive knowledge, integration experience and tools across 15 areas of the supply chain for the CPG vertical. The outcome is PeopleSoft EnterpriseOne SCM and FM 8.9, which provide an integrated, end-to-end solution tailored to the special needs of the consumer goods industry.

The consumer goods industry presents many unique processes that must be optimized to achieve baseline operational excellence. There are few benefits of being a large consumer goods organization unless the various operating companies, plants and distribution networks can be coordinated to deliver efficient sourcing, manufacturing, order management and fulfillment scale benefits. Many of these processes have proven problematic for packaged software solutions to meet without significant modification and or integration. The Accenture/PeopleSoft EnterpriseOne consumer goods solution addresses many of these key industry or "core" requirements as well as provides enhancements that specifically address the growth and innovation requirements of the industry.

The ability to optimize profitability represents a key area where consumer goods companies can achieve competitive advantage.

PeopleSoft EnterpriseOne SCM 8.9 addresses the entire range of supply chain requirements, from demand planning and forecasting to final profitability analysis. The integrated nature of SCM 8.9 gives a company the ability to manage promotion effectiveness, improve forecast accuracy, assess the profitability of orders, synchronize demand and supply across a company's extended supply chain, and understand the cost and profit implications of strategic investments. The functionality was designed and developed to accomplish three things:

- Provide specific industry "core" functionality (e.g., catch weight and size/ color/style)
- Enable consumer goods companies to grow and enhance their profitability

- Provide systems that are both easy to use and administer as well as provide a low total cost of system ownership

The ability to optimize profitability represents a key area where consumer goods companies can achieve competitive advantage. For this reason, the profitability management aspect of the Financial Management 8.9 solution is worth noting. It is designed to provide decision-making information to executives managing operations and planning changes to existing processes.

Most consumer goods companies employ standard costing models where costs are allocated to products and customers. Very often significant

differences exist in cost allocation when using an activity-based costing system. Hence, the ability to combine both traditional cost accounting and activity-based costing on a single matrix enables these organizations to better identify the real drivers of profitability.

PeopleSoft EnterpriseOne Financial Management 8.9 profitability management capability enables companies to analyze detailed direct, indirect and activity-based costs so as to develop accurate product (SKU level), customer, channel and plant profitability analyses. The ability to accurately compare these profitability analyses can significantly improve investment decisions and positively impact margins and growth rates.



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